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UNCLAS SECTION 01 OF 02 VIENNA 001097

SIPDIS

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TREASURY ALSO FOR OCC/EILEEN SIEGEL
TREASURY ALSO PASS FEDERAL RESERVE
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SUBJECT: AUSTRIA'S 2005/06 GROWTH OUTLOOK - STILL LEAN

REF: VIENNA 45

SUMMARY

1. The two leading Austrian economic institutes now forecast real GDP growth of up to 2.1-2.2% in 2005 and 2.3-2.5% in 2006. The institutes stress that these figures represent upper limits. The recovery is still export-driven, as investment and private consumption remain weak. The continued strength of the world economy, the recovery of Europe's internal demand, oil prices and the Euro-dollar exchange rate represent downward risks for the 2005/06 forecasts. The GoA's income and corporate tax cuts now have an anti-cyclical effect. Economic growth in 2005/06 will be insufficient for an improvement in the labor market. The unemployment rate will remain at 4.5%. Inflation will edge up to 2.2-2.5% in 2005 and ease to 1.7-1.8% in 2006. END SUMMARY.

2005 AND 2006 - CONTINUED MODERATE GROWTH

2. On April 1, the Austrian Institute for Economic Research (WIFO) and Institute for Advanced Studies (IHS) presented their revised projections for 2005 and 2006. The new figures represent very little change from their earlier prognosis (reftel). For 2005, WIFO maintained its growth expectation of 2.2%, while IHS reduced its by 0.2 points to 2.1%, assuming considerably higher petroleum prices. 2006 growth projections are now 2.3-2.5%. New WIFO Director Karl Aiginger noted that the forecasts are optimistic and represent the upper limits of possible growth. The Austrian economy is gaining momentum, according to Aiginger, but temporary weakness in the fourth quarter of 2004 has had some spill over effects in early 2005. Aiginger referred to the Austrian economy as being on a "bumpy upward trend." IHS director Bernhard Felderer stated that, in retrospect, the GoA's decision to cut 2005 income and corporate taxes proved correct, because the tax cuts now have an anti-cyclical effect. Both economists stated that the upswing was mainly export driven. Investment has not yet benefited from the export boom. Instead, it has weakened as private consumption remains weak, and the positive benefits from the 2003 and 2004 investment premium have receded. Investment should pick up somewhat in 2006, while private consumption growth will remain moderate. WIFO and IHS expect the savings rate to rise from 9.2% of disposable incomes in 2004 to 9.6% in 2005/2006.

RECAPPING 2004

3. In 2004, the Austrian economy grew 2.0% in real terms and 3.9% in nominal terms. Seasonally adjusted quarter/quarter growth rates (real terms) throughout 2004 were 0.6, 0.8, 0.8, and 0.3%. In nominal terms, Austria's 2004 GDP was Euro 235.1 billion (USD 292.2 billion), per capita GDP was Euro 28,890 (USD 35,820). Consumer price inflation was 2.1% and the unemployment rate was 4.5%.

RISKS - EXCHANGE RATES, OIL PRICES, ETC.

4. Aiginger and Felderer presented a list of downward risks for the forecasts. Since Austria's economy is still primarily export driven, a major risk is the continued strength of the world economy, particularly of the U.S. and Asia. Another risk factor includes Europe's continued anemic internal demand. Oil prices and the Euro-dollar exchange rate are additional risks.

ASSUMPTIONS FOR GROWTH FORECASTS

5. The institutes based their 2005/2006 forecasts on the following assumptions:

-- U.S. economic growth of 3.3-3.8% in 2005 and 3.1-3.3% in 2006;
 -- Euro area growth of 1.7-1.8% in 2005 and 2.2-2.3% in 2006;
 -- EU-25 growth of 2.0% in 2005 and 2.3% in 2006;
 -- German growth of 1.2-1.3% in 2005 and 1.8% in 2006;
 -- oil prices of USD 44-47 per barrel in 2005 and USD 39-47 in 2006; and
 -- dollar/Euro exchange rates of 0.75 in 2005 and 0.75-0.78 in 2006.

INFLATION TO TICK UP, UNEMPLOYMENT RATE STICKY

16. Inflation should edge upwards in 2005. Due to substantial increases in energy prices, housing costs and food prices, inflation over the past several months has increased to just below 3%, but should level off later this year. For 2006, the institutes expect inflationary pressures to ease to 1.7-1.8%.

17. Due to the export boom and the tax cut, Austrian economic growth is expected to exceed that of the Euro-area in both years. However, any growth of less than 2.5% is insufficient to improve labor market statistics. The unemployment rate will remain at 4.5%. Labor supply will continue to exceed demand because of a continued influx of foreign labor (over 10,000 Germans have come to Austria to work over the last several months), demographic developments, and the GoA's pension reform, which introduced a rise in the retirement age. Thus, despite record employment levels and a continued marked increase in employment, the unemployment rate in both 2005 and 2006 will remain at 4.5%.

PUBLIC DEFICIT GROWING

18. In 2005, the income tax cut will push the deficit to about 2.0% of GDP. To keep it below the 2%-mark, the GoA may have to resort to various one-time revenue-raising measures. However, the main impact of the 2005 corporate tax cut will be on the 2006 budget. With the expected stronger economic growth, the GoA should be able keep the 2006 total public sector deficit at the predicted 1.7%.

19. Statistical Annex

Austrian Economic Indicators (percent change from previous year, unless otherwise stated)

	WIFO project. 2005	IHS project. 2005	WIFO project. 2006	IHS project. 2006
Real terms:				
GDP	2.2	2.1	2.3	2.5
Manufacturing	4.0	n/a	3.7	n/a
Private consumption	2.0	2.1	2.2	1.9
Public consumption	0.5	0.2	0.8	0.2
Investment	1.8	2.3	2.7	3.1
Exports of goods	6.0	7.6	7.0	7.4
Imports of goods	6.0	6.8	7.1	6.0
Nominal Euro billion equivalents:				
GDP	245.5	244.6	255.0	254.7
Other indices:				
GDP deflator	2.2	1.9	1.6	1.6
Consumer prices	2.5	2.2	1.8	1.7
Unemployment rate	4.5	4.5	4.5	4.4
Current account (in percent of GDP)	-0.6	-0.1	-0.0	0.4
Exchange rate for US\$ 1.00 in Euro	0.75	0.76	0.78	0.75

BROWN